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Monthly Letter on
Economic Conditions
Government Finance

1950

New York, March, 1950

General Business Conditions

THE coal shortage has steadily tightened its grip on transportation and industrial operations, and as this Letter goes to press there is no indication when mining will be resumed. Railway service has been curtailed, steel production has dropped precipitously, "brownouts" are in force to save electricity, and manufacturing plants are now widely affected. Other fuels have made great inroads upon coal use in recent years, but the daily news of the past week or two shows that coal is indispensable and that the country cannot sustain the strike much longer. Probably this is the chief assurance that a way will be found to get production started again.

Reports persist that as a last resort the President will seek authority to seize the mines. Seizure has been invoked in past strikes, with consequences that should be well remembered. The miners have defied the Federal court order, under the Taft-Hartley Act, to resume work while negotiations go on, but they will hardly strike against the Government as an employer. They will be glad to get back on a payroll, and they will expect the Government to yield to most or all of their demands, make a contract, and return the mines to their owners with the deed done. Of course, such a procedure would destroy bargaining. In all likelihood it would force upon the owners, as past seizures have done, a settlement which would strengthen the power and monopoly position of the union, reward its long refusal to bargain as the law commands, make it even more difficult to deal with in the future, and saddle the industry with higher costs and consumers with higher prices. It would solve none of the basic problems, and in the long run would further reduce the use of coal and hence the miners' opportunity for employment.

Probably the outcome will be known before this Letter is read. Whatever it may be, another increase in coal prices is almost a foregone conclusion.

Spring Outlook Favorable

Apart from the effects of coal shortage, the business news has been favorable and the outlook through the Spring is almost everywhere considered good. The volume of trade is large, incoming business since the first of the year has been generally satisfactory, and most industries have good backlogs of unfilled orders. Department store sales in recent weeks have been running even with a year ago in dollars, which is a good showing considering that prices average lower. Retail sales of automobiles also show that demand and buying power are running large, for increases over last year, when cars were in shorter supply, are substantial. Automobile assemblies would be breaking records were it not for the Chrysler strike, and can be expected to reach a new postwar high after the strike is settled, if coal and steel shortages do not prevent.

Business statistics now available for January make good reading. One of the encouraging developments was an increase in new orders for machine tools to the highest figure for any month

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since August 1946. This gives preliminary support to predictions that the industries, while cutting back on plant expansion as compared with 1949, will be replacing and modernizing on at least an equal scale.

Orders for railway freight cars also have revived. At the end of last year the car manufacturers had almost worked themselves out of business. New orders in January, however, totaled 9,385, and with the New York Central ordering 4,500 cars February may have produced an even larger total. The McGraw-Hill survey of prospective capital expenditures for 1950, made around the turn of the year, forecast a drop of 44 per cent in railway spending for improvements and equipment as compared with 1949, but the prospect now seems a little brighter.

Construction continues very active. In January new housing starts totaled 80,000 against 50,000 a year ago, and the daily average contract awards, according to the Dodge reports, were 57 per cent larger. In the first 22 days of February the increase in awards was 27 per cent. It is plain that construction activity will give strong support to business during the Spring. Lumber orders since January 1 have run 22 per cent above last year.

Paper mill operations have been running well above a year ago, and new orders for paperboard, which is used in almost all lines of business, have been very large. On a daily average basis the consumption of raw cotton in January was 20 per cent above last year, and cotton mills are well sold through the second quarter. Manufacturers of household goods and appliances are very busy. After the resumption of coal mining, when it comes, a "catching up" period in coal and steel will add to the general activity.

The foregoing warrants the opinion that the upturn in industrial output and employment which began last Summer has not yet spent itself, and that the setback caused by the strikes will be made up when people get back to work. In a few lines there are indications that primary production may be outrunning the consumption of finished goods, and that inventories are being built up. But mercantile buyers are keeping commitments under close control and the National Association of Purchasing Agents reported in February that 78 per cent of its members were buying for sixty days or less. Industrial prices on the average continue to move sideways, as they have for several months. This signifies a stable situation. In the absence of markedly advancing price trends, and with many people uncertain as to the outlook toward the end of the year, optimism is not likely to be seriously overdone.

The British Election

The outcome of the second postwar election in Great Britain, held on February 23, lacked the stunning surprise of the Labor Party's landslide in the Summer of 1945. Guided by the trends of recent polls and by-elections in Great Britain, and by election outcomes in other parts of the Western World, most informed observers foresaw a swing to the Right, and hence a more closely divided electorate.

The December elections in New Zealand and Australia, the two countries where social democracy had advanced the farthest, had furnished the most recent indications of the trend away from socialism and state controls. In both countries, the Labor Administration was turned out after an office tenure of many years. A similar trend toward non-socialist political orientation was indicated by the earlier elections in Austria, Western Germany, and Belgium. In France, and Italy, the shift away from government controls toward a modified free price economy started even earlier, in 1947 and 1948.

Labor Victory in 1945

Following the war there had appeared a rising "tide in the affairs of men" (to recall the words in Shakespeare's Julius Caesar) towards a new form of social order, the Socialist State. The movement was the outgrowth of restlessness and disillusionment brought on by the war, a dissatisfaction with existing institutions, and a feeling that new leadership and new methods were required for the reconstruction problems.

It was on this tide of revolt that the British Labor Government was swept into office by a huge majority in 1945. Not having held the responsibilities of office except as it shared in the wartime coalition government, the Labor Party was not handicapped during the campaign by having had to deal with the hard realities of the ten difficult inter-war and war years during which the Conservatives held the helm.

Despite the appalling disorganization and wastage of the war, the Labor candidates held forth alluring prospects of more leisure, more social welfare, and a higher standard of living generally to be realized by the people under a socialist regime. The method by which they hoped to better the lot of the average man was the redistribution of wealth—"fair shares for all." This was based on the presumption that there was plenty of wealth, and that all there was to do was distribute it.

With acceptance of responsibility, however, socialism has had to face stern tests. Now the shoe is on the other foot; socialist governments

have been expected to make good their promises. Temporarily, they may have given the impression of delivering, partly because they made reforms long overdue, and partly because it is not immediately clear who pays for socialist policies and what the cost is in terms of cramping controls and the regimented life.

But gradually people have begun to see the weaknesses.

1950 Campaign Influences

The principles on which the two major British political parties sought the support of the electorate were set forth in party manifestoes, corresponding to our party platforms.

When it came to actual voting, however, it is doubtful whether the British people were any more influenced by the resounding pronouncements of party manifestoes than the people in this country are by party platforms. Of far greater importance, probably, have been the reactions of individual voters to the particular circumstances of their lives during the past five years of Labor rule.

For the great mass of the low income people support of the Labor Party was assured by the program of subsidies of all kinds and expansion of the social services, which have made these groups of the population better off, by and large, than ever before. Though these programs have been at the expense of the middle classes and of the American taxpayer who has provided Marshall aid, these facts have hardly been calculated to impress the recipients of these benefits.

It is true that the squeeze between incomes and rising prices has been an increasing source of friction with the trade unions, and one which promises to grow more intense as the effects of devaluation work into the price structure. But so far, the full effects of devaluation on living costs have been delayed by the substantial stocks of goods on hand and by the Government's ruling that manufacturers must not raise prices until current supplies of raw materials are exhausted. In this way the evil day of rising retail prices was put off until after the election.

No doubt fear of unemployment played its part in holding the working class in line. Labor candidates hammered hard on the theme of the "bad old days" of depressed industries and living on the dole under the Conservative government, much as Democratic candidates in this country are wont to hark back to 1933. Though the Conservatives retorted that they too were for full employment, that there had been unemployment before under socialist governments, and that the current full employment was more the result of postwar reconstruction needs and Marshall aid than of government management, the effectiveness of such arguments on the "man in the street" is questionable. The average workingman, with a good job and more free services than ever before, is not likely, despite minor irritations, to rush out and vote for change.

Against this hard core of labor support has been the evident defection of great numbers of middle class and independent voters whose anti-Conservative ballots had contributed so largely to the Labor sweep in 1945. Under the wealth distributing policies of the Labor Government the great middle class has seen itself steadily impoverished. At the same time there has been growing disillusionment and resentment in all classes over government restrictions and taxes, and promises that can't be fulfilled.

The devaluation of sterling last Fall probably had more influence than anything else in bringing home to the thinking people of Britain a realization of the weakness of their economic position. The truth is that the British have been attempting to distribute to the people what they did not in fact have to distribute. The way this has showed up in Britain has been in devaluation.

In appraising the election swing, it should be recognized that in the period of the Labor Government certain increases in the power and services of the State, and in the distribution of wealth, have become so firmly established that the Conservative Party in its campaign pledged their continuance, but with a different underlying philosophy and more emphasis upon setting free the forces of private initiative.

The Moral

The moral of all this is clear. The fine things that are promised by socialism and the welfare state are not conjured out of the air. Somebody has to pay for them, and the process of robbing Peter to pay Paul can go only so far.

The answer, then, must be that if society wants to distribute more it must produce more. There can be no hen-or-the-egg argument as to which comes first. In the words of Mr. Rupert Beckett, retiring chairman of the Westminster Bank of London, at his annual meeting last month:

> Of recent years we have witnessed a change from the conception of the State as an impartial umpire in economic affairs to that of the State as the guarantor of a certain standard of material welfare. Much of the progress that has accompanied this change of ideas has been entirely desirable in itself. But the Welfare State has so far remained an organization for distribution; its productive function has not yet reached much consideration. The time has come when, if this latest Utopia is not to go the way of earlier models, attention must be transferred to the less attractive side.

Corporate Earnings Lower

Annual reports for 1949 published to date by some 2,100 corporations confirm the showing of the quarterly reports summarized in this Letter during the year. They show that the high tide of corporate profits generally was reached in 1948. Though aggregate earnings of companies thus far reporting were only moderately below the record figures for 1948, and make 1949 one of the more prosperous years in American history, results in different industries varied widely. To a large extent the totals were supported by the automobile and certain other important industries whose continued star performance tended to offset declines taking place elsewhere. For the great majority of industries and individual companies 1949 results fell below those of 1948, in many cases by wide margins.

More specifically, reports of 2,127 companies now available show for 1949 a combined net income, after taxes and after deducting deficits, of approximately $6.3 billion, a decrease of 9 per cent from the $6.9 billion net income in 1948. The accompanying table, giving comparisons by major industry groups, shows the heavy preponderance of minus signs, which is in sharp contrast with the showing during the past few years of business boom. This preliminary summary does not include the reports of many of the country's largest business organizations that will be available for the detailed table in our April issue. That summary will show, as usual, by 70 major industrial groups, average rates of return on net assets and profit margins on sales.

Trends in the Manufacturing Industries

Of the 1,006 manufacturing companies thus far reporting, 70 per cent had smaller earnings last year, against 30 per cent with increases. Among the principal subgroups, it will be seen that 28 show decreases against only 6 with increases, and that percentage declines were particularly heavy in some of the food products, textiles, rubber tires, pulp and paper, petroleum, household appliances, and miscellaneous metal products. The fact, however, that declines were generally from high levels tended to soften their impact, and in many cases to leave adequate margin for maintenance of current dividends in view of lessened demands upon cash for plant and equipment expenditures.

One hundred and eleven of the reporting manufacturing companies had deficits totalling $53 million, after allowance for credits under refunds of prior year's taxes to which they are entitled by law. This compares with 59 companies, out

Preliminary Summary of Net Income of Leading Corporations for the Years 1948 and 1949

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1948	1949	Per Cent‡ Change
15	Baking	$ 55,450	$ 48,968	—12
16	Meat packing	45,951	30,050	—35
19	Sugar	45,269	29,762	—34
65	Other food products	167,600	136,234	—19
9	Distilling	137,578	108,557	—21
15	Tobacco products	90,250	101,233	+12
32	Cotton goods	115,588	46,056	—60
49	Other textile products	193,091	101,912	—47
21	Clothing and apparel	21,225	13,119	—38
21	Shoes, leather products	29,550	20,626	—30
13	Tires, rubber products	80,530	58,387	—27
27	Lumber, furn., wood prod.	62,413	28,800	—54
40	Pulp and paper products	140,165	97,158	—31
17	Printing and publishing	23,892	21,391	—10
45	Chemical products	400,161	439,120	+10
17	Drugs, soap, cosmetics	96,541	67,120	—30
14	Paint and varnish	29,219	21,681	—26
21	Petroleum products	299,841	220,691	—26
18	Cement	32,241	37,888	+18
7	Glass products	47,898	61,471	+28
22	Other stone, clay prod.	77,378	66,392	—14
87	Iron and steel	540,283	532,324	— 1
10	Agricul. implements	127,426	155,291	+22
41	Build., heat., plumb. eq.	78,823	56,403	—28
42	Elec. equip., radio & tv.	183,553	173,276	— 6
27	Hardware and tools	28,141	20,353	—28
19	Household appliances	39,550	21,091	—47
100	Machinery	131,871	94,445	—28
15	Office equipment	51,035	41,683	—18
74	Other metal products	197,180	166,153	—16
13	Autos and trucks	476,550	624,655	+31
43	Automobile parts	102,454	100,193	— 2
16	Railway equipment	43,895	34,701	—21
66	Misc. manufacturing	41,018	36,051	—12
1,006	Total manufacturing	4,233,610	3,813,235	—10
19	Coal mining*	62,943	31,226	—50
10	Metal mining*	20,372	16,907	—17
19	Oil and gas*	77,095	63,632	—17
8	Other mining, quarry.*	32,487	34,570	+ 6
56	Total mining, quarrying	192,897	146,335	—24
11	Chain stores—food	36,457	44,484	+22
33	Chain stores–variety, etc.	132,765	112,676	—15
32	Department & specialty	105,452	94,617	—10
38	Wholesale and misc.	76,103	51,652	—32
114	Total trade	350,777	303,429	—13
132	Class 1 railroads	698,057	436,000	—38
12	Traction and bus	2,902	3,092	+ 7
6	Air transport	—5,024	7,341	+…
26	Misc. transportation	17,679	22,554	+28
176	Total transportation	713,614	468,987	—34
115	Elec. power, gas, etc.	451,147	487,463	+ 8
31	Telephone & telegraph	238,320	248,237	+ 4
146	Total public utilities	689,467	735,700	+ 7
13	Amusements	15,803	17,736	+12
29	Restaurant and hotel	5,795	4,522	—22
17	Other business services	28,317	28,589	+ 1
10	Construction	6,164	6,596	+ 7
69	Total amuse., serv., etc.	56,079	57,443	+ 2
292	Commercial banks†	434,264	464,816	+ 7
20	Fire and casualty ins.†	45,888	75,898	+65
133	Investment companies†	151,144	178,373	+18
37	Sales finance companies	44,591	47,953	+ 8
78	Real estate companies	8,943	8,299	— 7
560	Total finance	684,830	775,339	+13
2,127	Grand total	$6,921,274	$6,300,468	— 9

*Net income is reported before depletion charges in some cases. †Figures represent in some cases operating earnings only, excluding gains or losses in investments. ‡Increases or decreases of over 100% not computed. —Deficit.

of 1,006, with deficits totalling $36 million in 1948.

Since this corporate sampling is representative for the most part of the larger and older-established enterprises, the decline in net earnings and increase in deficits in many groups suggest even more severe pressure on the many thousands of small recently-established corporations, partnerships, and individual proprietorships, which have more limited experience and financial resources.

Moreover, the reported earnings of corporations generally still reflect, under the conventional accounting practice, depreciation charges based upon original costs of plant and equipment, which are far below replacement costs. Were depreciation charges to be stepped up to the basis of present-day costs, the reported net income would be reduced correspondingly. While a great deal of study and discussion has been devoted to this problem, comparatively few companies have dealt with it in their reports by extra charges against income for accelerated depreciation, or by appropriations from net income for high-cost replacement reserves.

Factors in Lower Earnings

Declines in earnings reflect, in varying degree, economic conditions that are becoming more and more general in the manufacturing industries. Following the wartime conversion of production to military needs, industry has been able, through heavy investment in peacetime expansion and modernization of plant and equipment, to increase greatly its production and thereby catch up with demand. This has been bringing an end to scarcities and sellers' markets, depleting backlogs of unfilled orders, and creating competitive conditions which have forced price cuts in many lines. Some recession in dollar volume of sales was quite general last year.

At the same time, labor costs have remained high or actually advanced, and operating expenses for many other items (raw materials, supplies, fuel, transportation, taxes) are relatively inflexible. The inevitable result has been a squeeze of profit margins.

A new factor of growing importance is the spread of industry pension plans, the fixed charges of which, unless covered by increased selling prices or improved productivity, must be reflected in lower net earnings. United States Steel Corporation estimates that the recently-adopted steel industry insurance and pension plan will add to the costs of that company alone approximately $67,500,000 annually.

Aside from the foregoing influences on operating costs, earnings of some companies were affected adversely by strikes and other special factors last year. One was the loss on inventories, due to the drop in market prices of commodities on hand, in excess of that provided for by inventory reserves. Another was the loss on foreign assets, due to the widespread devaluation of foreign currencies last Fall. This also cuts down the dollar equivalent of such current earnings of foreign branches and subsidiaries as are permitted to be transferred here.

Despite the generally downward trend of earnings in the manufacturing industries last year, a number of important branches held their own or made gains because of the continued heavy demand for their products. Increases in net income are shown in the group totals — though by no means always in the case of individual companies — for automobiles, agricultural implements, cement, glass, tobacco, and chemicals. Earnings of the iron and steel industry were slightly below those of 1948.

In most cases where increases occurred in dollar net income, they were accompanied by increased volume of sales based upon expansion of investment in productive capacity. Most profit margins on sales and rates of return on net assets were appreciably below those of the preceding year.

Trends in Non-Manufacturing Lines

In the mining industries, about three out of four companies reporting thus far show lower earnings. Operations in bituminous coal mining were severely curtailed by strikes and shortened work-weeks. Nonferrous metal mining was also affected by strikes, and by lower selling prices of metals and ore concentrates.

Total volume of retail and wholesale trade was only slightly below the record level of 1948, but profit margins of most chain, department, and specialty stores, as well as wholesalers, were squeezed by high operating costs and, in some cases, by inventory write-downs for clearing stocks. Several of the food chains, however, increased slightly their dollar sales and their traditionally narrow profit margins.

Railroad gross revenues for all class 1 systems declined 11 per cent, reflecting the coal and steel strikes and lower industrial production generally, and despite some advance in freight and passenger rates. With high operating expenses, including a rise in labor costs from shortening the work-week, estimated net income fell 38 per cent. A number of air transport companies enjoyed a

further growth in gross revenues, due in part to higher fares and mail pay, and, through better control of expenses, made a recovery from the deficits incurred in 1948. Most electric and gas utility systems had moderate increases in both gross and net income.

The grand total of 2,127 companies in all lines included in this preliminary summary had book net assets, based upon the excess of total balance sheet assets over liabilities, aggregating $62.8 billion at the beginning of 1949, upon which the year's net income represented an average return of 10.0 per cent. This compares with net assets of $57.7 billion in 1948 and a return of 12.0 per cent. The rate of return on the replacement cost of assets is of course substantially lower than that computed on the book values based largely on original costs less depreciation.

An Example of Economic Law

The experience with profits over the past year has given fresh demonstration of the way the self-adjusting forces of the economic system exert their influence. There has been great hue and cry about the "exorbitant" profits of industry, and much agitation for dealing with them by taxing them away, paying them out in increased wages, or suppressing them by price controls. The fact is that these profits have been the result of an abnormal demand for goods greatly in excess of supply.

Business men know, however, that such conditions are temporary, and that sooner or later increased production will end scarcities, check price inflation, and bring profits down. That is precisely what has been happening. Stimulated and aided by the good earnings of the past few years, industry has been expanding its facilities and pouring increased quantities of goods into the markets. During the four years 1946-49, from one-half to nearly two-thirds of the net earnings of all American corporations were devoted to this purpose, rather than paid out in dividends to shareholders. Thus the problem of what to do about "excessive" profits, which has been worrying so many people, has been solving itself, in an orderly way, through the natural workings of increased production and competition. Any attempt to place arbitrary restrictions upon earnings would have diminished the effectiveness of the principal influence making for such adjustments, and delayed the return to more normal conditions.

Uses of Corporate Funds

Year-end balance sheets issued to date by the larger industrial companies show an improvement in working capital and liquidity in most cases, despite the continued heavy demands upon cash for investment in plant and equipment. There was a release of cash from liquidation of inventories and receivables, and a reduction in current liabilities, while capital funds were built up from retention of earnings. The accompanying statement of 150 manufacturing companies, each having sales or total assets over $5 million, shows the balance sheet items for 1948 and 1949, and gives a comparison with prewar 1940 and with 1945, the end of the war.

Composite Balance Sheet of 150 Manufacturing Companies with Sales or Total Assets over $5 Million

(In Millions of Dollars)

	December 31			
Assets	1940	1945	1948	1949
Cash	$ 500	$ 759	$ 792	$ 837
Government securities†	51	702	572	882
Receivables, net	489	797	1,039	924
Inventories*	1,140	1,682	2,823	2,541
Total current assets	2,180	3,940	5,226	5,184
Land, plant & equipment	3,391	3,814	5,385	5,720
Less depreciation	1,602	2,365	2,721	2,872
Net property	1,789	1,449	2,664	2,848
Other assets	389	339	362	390
Total assets	4,358	5,728	8,252	8,422
Liabilities & Capital				
Notes payable	56	183	217	135
A/c pay., accruals, etc.*	289	527	709	625
Reserve for taxes†	211	667	691	569
Total current liab.	556	1,377	1,617	1,329
Bonds, notes, etc.	590	419	1,332	1,285
Reserves	62	116	156	169
Capital and surplus	3,150	3,816	5,147	5,639
Total	4,358	5,728	8,252	8,422
Working capital	1,624	2,563	3,609	3,855
Ratios:				
Current assets to current liab.	3.9	2.9	3.2	3.9
Equity capital to total liab.	2.7	2.1	1.7	2.2

†Before deducting tax notes offset against taxes payable.
*Includes advances on government contracts.

This statement comprises companies whose sales aggregated approximately $10.9 billion last year, and whose combined assets totaled $8.4 billion at the year-end. It will be seen that the moderate increase in total assets last year was more than accounted for by increased investment in plant and equipment.

Inventories, after rising sharply from 1945 to '48, turned downward in '49 and receivables declined slightly. Holdings of cash and government securities were augmented, while current liabilities and long-term debt were reduced. This improved both the ratios of current assets to current liabilities, and of equity capital to total liabilities.

Comparison of the '49 figures with those of '45 indicates the heavy investment of funds needed since the war for the expansion of current and fixed assets. Total assets of this group of companies increased by almost $2.7 billion, divided about equally between net expenditures on the expansion and modernization of plant and equip-

ment, and for rebuilding inventories at advancing prices.

About two-thirds of this expansion in assets was reflected in the growth of equity capital and surplus, practically all representing retention of earnings rather than sale of additional stock. The remaining third was obtained by long-term borrowing.

Treasury Refunding Plans

In light of the Winter's discussions of the need for flexibility in credit policy and interest rates, more than the usual interest was displayed in the Treasury's plans for handling its March-April maturities. These aggregate $9.4 billion and embrace two issues of certificates, one issue of bonds and one issue of notes. The plans, as announced February 14, are summarized in the following table:

Maturing Security	Offering in Exchange
$2.9 billion 1¼% certificates, due March 1, 1950	New 16-mo. 1¼% notes, due July 1, 1951
$2.0 billion 2% bonds, called for payment Mar. 15, 1950	New 5-year 1½% notes, due March 15, 1955
$3.6 billion 1⅜% notes, due April 1, 1950	
$1.0 billion 1¼% certificates, due April 1, 1950	New 15-mo. 1¼% notes, due July 1, 1951

The announcement, favorably received in the market, confirmed some earlier indications that the Treasury was moving toward a more flexible policy in handling debt maturities. The rather stereotyped procedure, in effect since the war, has been to offer one-year certificates of indebtedness, with a rate never exceeding 1¼ per cent, to holders of maturing securities, including many bonds carrying interest coupons of 1¾ to 2¾ per cent. Apart from portions redeemed in cash, this policy meant a continuous rolling over of maturing certificates into new certificates, and a conversion of notes and bonds, reaching maturity or called for payment, into more certificates. This time certificates are omitted, and the emphasis is on cutting down the number and amount of nearby maturities and supplying intermediate-term securities which better suit market demands.

No announcement has yet been made of borrowing plans to cover the Federal deficit. Current government expenditures are being covered out of the heavy first quarter tax revenues. Borrowings required later in the year are estimated at around $5 billion.

Revival of Note Financing

The offering of three series of notes—two "short" and one "long"—following upon similar offerings in December and February, represents a revival of note financing, a type of security in the one-to-five year range which, through lack of new issues, had been threatened with extinction.

The greatest market interest was naturally attracted to the five-year notes which mature March 15, 1955. This represents at least a start toward filling in a relative scarcity of government maturities in the five-to-ten year range. During the war, $39 billion bonds were issued in this maturity range. With the passage of time some of these have already been paid off or refunded into certificates. The remainder now mature in less than five years. Longer-term bonds sold in war financing, 2¼s and 2½s, are largely concentrated in what is now the ten-to-twenty year range. The present relative scarcity of maturities in the five-to-ten year range — 1955-60 — is a serious obstacle to investors who like to space out the maturities of their government security holdings in order to reduce or eliminate risks of having to sell under unfavorable market conditions.

Deemphasis of certificates is timely and a move in the direction of traditional financing methods. While used liberally in the two wars, certificates have never been a major feature of peacetime financing. Large and frequent certificate maturities were a convenience in 1946-48, when substantial funds were available for debt retirement from the proceeds of the last War Loan drive and from surplus revenues. Now there is no necessity to use up surplus cash — which is nonexistent — and there is a necessity to avoid building up an excessive supply of short-term paper which naturally tends to gravitate into the banking system and to leave the demands of many nonbank investors unsatisfied.

An overload of floating debt, of which certificates comprise the largest single part, moreover always holds a threat of becoming — in a period of stress or emergency — a source of embarrassment to the Treasury. Every wise borrower — public or private — keeps his debts manageable by scheduling out obligations that have to be met. While a government may violate this principle for a time and get away with it, principles based on long experience have a way of reasserting their validity. Our government has undertaken new programs in the control of the government security market, but nobody knows how they will stand up in a real emergency when there is strain on public psychology stirred by unforeseen events.

The following table brings out the heavy concentration of floating debt — obligations due or callable within one year — as of the close of last year. While the amount has been reduced by

$14 billion since the close of 1945, the $56 billion remaining total is 36 per cent of the total public marketable debt — Treasury bills, certificates, notes and bonds of the type traded in on the open market. The prewar proportion was only 10 per cent. The table also brings out the small proportion — 12 per cent — of obligations in the five-to-ten year range.

Maturity Distribution, Public Marketable Debt

	Due or Callable					
	Within one year	One to five years	Five to ten years	Ten to twenty years	Over twenty years	Total
	(In Billions of Dollars)					
Dec. 31, 1939	$ 3.4	$10.4	$10.1	$10.7	$ 0.1	$ 34.7
Dec. 31, 1945	70.4	35.4	33.0	35.0	24.8	198.6
Dec. 31, 1949	56.3	35.1	18.5	45.1	—	155.0
	(In Percentages of Total)					
Dec. 31, 1939	9.7%	30.2%	29.2%	30.8%	0.1%	100.0%
Dec. 31, 1945	35.5	17.8	16.6	17.6	12.5	100.0
Dec. 31, 1949	36.3	22.6	12.0	29.1	—	100.0

Source of basic figures: U. S. Treasury.

The March-April refundings will reduce the outstanding amount of certificates from $27 billion to $23 billion and the floating debt correspondingly. Other elements in the floating debt are Treasury bills, outstanding in the amount of $12 billion, which are being constantly rolled over from week to week. On September 15, $6.1 billion of 2 and 2½ per cent bonds become callable for payment and $2.6 billion 1½ per cent bonds fall due December 15. The following two years are scheduled to require even bigger refunding operations. In 1951 and 1952, nine bond issues, totalling $29 billion, become callable for payment.

Immediate Background

In testimony before the Congressional Joint Committee on the Economic Report a year ago Secretary of the Treasury Snyder pointed out the magnitude of the refunding problems in 1950 and succeeding years and gave an indication that policies would be changed when the time came. In September 1948 the pattern of refunding maturities with one-year certificates had been briefly interrupted when 1⅜ per cent 18½ months' notes — the ones falling due this April — were issued in exchange for bonds and notes then maturing. A decisive modification of policy, however, did not appear until December 15 last, when 1⅜ per cent notes maturing March 15, 1954 — a four and one-quarter years' term — were offered in exchange for maturing 2 per cent, 2½ per cent and 3⅛ per cent bonds and a small issue of 1¼ per cent certificates. On January 1 a certificate maturity was rolled over into certificates on the familiar pattern, but the February 1 certificates were offered 1¼ per cent notes maturing October 1, 1951 — a twenty-months' term. Now the March and April certificates are to be refunded into paper of sixteen and fifteen months' term. The March and April bond and note maturities are to be refunded into notes of five years' term, the maximum period for which notes are issued.

Slight Improvement in Yields

The successive refundings since December involve not only a stretching out in term but also a discernible improvement in the yield structure. The new five-year notes carry a 1½ per cent coupon compared to 1⅜ per cent for the four and a quarter year notes issued in December. The 1¼ per cent notes for sixteen and fifteen months in March-April compare to twenty months for a similar coupon in February. The one-year certificates issued in January have recently been traded in the market on a 1.16 per cent yield basis.

The slight improvement in yields reflects a tailoring to market conditions. The Federal Reserve authorities during this period, while refraining from positive action to tighten up the supply of credit, have taken up some of the slack that existed at the year-end plus slack that has subsequently developed from seasonal reduction in currency circulation. One noteworthy change in policy has been a resumption of sales of long-term government bonds out of the Federal Reserve portfolio. These sales have held in check a new boom psychology in the bond market, akin to that which prevailed immediately after the war when investors were seized with fears that there might be a shortage of government bonds. One great danger in such a psychology is that government bonds may reach levels that will discourage their purchase and holding by stable investors and encourage a speculative following. The bonds released out of the Federal Reserve holdings in recent months, on a slowly declining market, presumably have gone into hands more interested in obtaining a given investment yield than in price fluctuations.

A New Policy Emerging?

Out of the refundings beginning with December, there emerges the outlines at least of a new pattern of refunding policy which includes:

A deemphasis of one-year certificates, a rather overworked financing medium in recent years;

Revival of note financing, a popular medium for commercial banks and other classes of conservative investors;

Providing maturities in the vital five-to-ten year (1955-60) range where there is now a gap;

Restoration of two-way flexibility in Treasury financing — in term as well as interest rate.

Continuance and extension of this pattern of policy could, over time, improve the structure of the marketable public debt from both the standpoint of the Treasury and the investor in government obligations. The postwar record has brought home the lesson of how frequent, large maturities of Treasury obligations, which have to be refunded, have tended to become the engrossing concern of the Federal Reserve in its conduct of open market operations and have led to conflict between the Treasury and Federal Reserve authorities on the terms to be offered. If more of the debt maturities are spread out into the future, the problems of making decisions on handling current maturities — and on borrowings to cover new cash requirements — are easier. When, as now, there is a firm demand for intermediate and longer-term government securities, the opportunity is afforded to do it.

The Farm Surplus Problem

The problem of surplus farm commodities, due to overproduction at high government support prices, has reached the headlines in dramatic fashion during the past month through Secretary of Agriculture Brannan's announcement that 25 to 40 million bushels of potatoes would be allowed to rot in the fields or sold back to the growers for animal feed at 1 cent per 100 lbs. For these potatoes the Government has paid, on the average, $1.83 per 100 lbs. During the past four years the potato surplus has become chronic, although acreage has been restricted for three years and price supports were lowered last year. Since the support program started, spoilage and losses incurred in surplus disposal have cost the taxpayers some $420 million.

Meanwhile the people who have been paying the taxes have also been paying an artificially supported price for the potatoes they eat. They have been subsidizing the growers, to the end that the market price may be raised when they go into the store to buy. Now comes the record of waste and uneconomic use. In theory, acreage restriction has been supposed to keep supply and demand in balance at the arbitrary price. But the price has been attractive enough to induce farmers to plant their potatoes more closely, to use more fertilizer and insecticides, and thus offset the lower acreage with higher yields. The surpluses and the waste, all paid for out of the public purse, have followed.

It is not surprising that to many people the whole program appears to have become a travesty on sound economics and on common sense, and that potatoes have become a symbol of a strange and wonderful economic fairyland into which "planned economy" ideas and programs have led us. In any case public resentment has risen. It is forcing Congress to a critical reappraisal of the farm price support policy. In the Senate it led to an attempt, which was unsuccessful, to remove supports entirely from the 1950 potato crop, even though part of it has already been planted under a definite price commitment. The Senate has voted, however, to eliminate supports on the 1951 crop unless there are strict marketing quotas limiting the quantities on which growers may receive the support price.

Price Supports in a Critical Stage

There are other signs that the price support policy has reached a critical stage. While headlines have focussed on the potato surplus, the wastage of agricultural resources through accumulation of butter, egg, and milk surpluses is potentially even greater. The Commodity Credit Corporation acquired more than 100 million lbs. of butter in its 1949 support operations, for which no market demand exists at current support prices. With flush production only a few weeks away, it faces the accumulation of an even greater surplus this year. Butter production is running 10 per cent heavier than last year. With the 1950 support price actually 1c higher than the initial 1949 support, butter consumption is meeting increased competition from margarine made from low-priced vegetable oils, which are not supported.

Some 73 million lbs. of dried eggs, the equivalent of about 1½ dozen shell eggs for every person in the country, have been accumulated as a result of supporting egg prices over the past two years. Although the 1950 support price has been reduced 10c a dozen, egg production continues well above a year ago and the Commodity Credit Corporation currently is buying twice as many dried eggs as it was a year ago at this time. Together with 169 million lbs. of nonfat dry milk solids, these holdings have been offered in the export market at far below cost, but without finding buyers. Within the past month they have been made available, free of charge, to schools and welfare agencies.

Of course, public sentiment will not condone the destruction of such valuable foods, and will prefer to have them given away. But the real question is, why do the markets not clear themselves, in this period of high employment and purchasing power? Historically, this country always has been able to consume all the dairy and poultry products that were produced under free

prices. The failure to do so now is plainly due to unrealistically high support prices, which are not only causing heavy financial loss, but prevent alignment of production and consumption, without which the losses will become chronic. Higher prices encourage demands for higher wages, pensions and social security payments.

Storage and Financing

Great surpluses are also appearing in commodities such as cotton, wheat, corn and flaxseed. These surpluses are creating storage problems. The Commodity Credit Corporation has asked for bids on another 100 million bushels of bin capacity to take care of expected defaults this Spring on loans made on last year's wheat, oats and barley. This storage is in addition to the 375 million bushels of bin capacity erected by C.C.C. last Fall to take care of the corn surplus.

On present supply-demand trends, the Government should hold at the end of the current crop year close to 6,000,000 bales of cotton, around 350,000,000 bushels of wheat, perhaps 600,000,000 to 650,000,000 of corn, and the equivalent of close to 45,000,000 bushels of flaxseed, partly in the form of linseed oil. In terms of domestic consumption, these stocks (over and above trade stocks), would be equivalent to around eight months' supply of cotton, six months' supply of wheat, and about 15 months' supply of flaxseed and linseed oil. If a 1950 flaxseed crop were omitted altogether, there would still be enough to meet requirements until the 1951 crop.

The piling up of surpluses is creating a more acute financial problem for the Commodity Credit Corporation than appeared likely even a few months ago. On December 31, 1949 C.C.C. had a total investment of $3,645 million in commodities, consisting of loans made on 1949 crops of $1,920 million, and inventories owned as a result of defaulted loans on 1948 and prior crops of $1,725 million. Secretary Brannan told the Senate Agricultural Committee last month that C.C.C. expects to have some $3,900 million tied up by the end of this crop year. Allowing for sale of inventories and repayment of loans, he estimated that the minimum peak requirement to support next year's crops, even under the most favorable circumstances, including full compliance with acreage cut-backs, lower farm production, and continued high domestic demand, would be $4,900 million. Given a continuance of the favorable weather of the past few years and high yields from intensive cultivation of the best acreage, he admitted that C.C.C. would need up to $5,900 million in 1950-51. Since its borrowing power now is only $4,750 million, he asked for a $2,000 million increase, to $6,750 million, which increases the deficit and the public debt, on which we all pay interest.

Ever-Rising Price Supports

The policies which are building up these surpluses at such immense cost are being viewed with increasing concern by farmers, as well as by the city people who pay the prices. The high price support policy was successful in stimulating production during the war. In guiding production back to peacetime requirements, the evidence now developing is that it is failing lamentably. The prices required by law, or by political pressures, are too high to equate supply and demand.

The history of the farm program, from the depression years on, is one of continuous raising of support levels. During the '30s, crop loans were limited to "basic" crops – wheat, corn, cotton, rice and tobacco – and fixed by law at not under 52 and not over 75 per cent of the calculated parity; they were largely permissive instead of mandatory; and they were usually set at or near the minimum. In 1941 loans were made mandatory at 85 per cent of parity; in 1942 at 90 per cent. In the same year mandatory support programs were extended to thirteen "Steagall" commodities, in which greater production was needed during the war; farmers were promised this protection for two years after the technical end of the war, which was proclaimed by President Truman December 31, 1946.

In 1947 and 1948 Congress gave much attention to the formulation of a program to follow the two-year adjustment period, and in 1948 the Hope-Aiken Act was passed. This provided in general for "flexible" price supports. The Secretary of Agriculture was given authority to set rates between 60 and 90 per cent of parity on basic crops, and even down to zero on the Steagall commodities if deemed necessary. This Act was originally to take effect January 1, 1949. However, political opposition to lowering the support levels forced a one year postponement of its effective date, and before it could come into effect on January 1, 1950 it was superseded by a new law which continued mandatory supports on the 1950 basic commodities (with acreage allotments or marketing quotas in effect) at 90 per cent of parity, and on other commodities at somewhat lower levels, while in some cases the supports changed from mandatory to permissive after dates specified in the act. At the same time new formulas for the calculation of parity prices were adopted, which had the effect of raising them. Beyond 1950 the law contemplates 80 to

90 per cent supports on the basic crops for 1951 and 75 to 90 per cent supports in 1952 and thereafter.

In lieu of lower prices, acreage restriction is counted on to balance the supply. But as seen in potatoes, compulsory acreage restriction is a weak reliance. It is unpalatable, especially to efficient, low-cost farmers, and resentment creates political pressures. This year the Senate and House have both passed legislation to compel an increase in the cotton, wheat and peanut acreage quotas above those originally set by the Department of Agriculture. If support prices are attractive, intensive cultivation increases output per acre. At the same time supported prices discourage the growth of consumption.

The Farmer's View

Evidence is mounting that farmers themselves are wondering where all this leads to. Last June, potato growers in California, who supply about half the country's early crop, voted against marketing agreements on their 1950 production. While this action makes them ineligible for price support this year, their acreage is not restricted; and by the use of modern methods of cultivation, irrigation, improved fertilizers, and new insecticides, they evidently intend to compete in the free market with a quality product. Growers in a number of other areas, accounting for about 30 per cent of the country's potato production, including the surplus areas of Long Island and New Jersey, likewise will be ineligible for loans this year unless they vote favorably on marketing agreements before planting time. Poultrymen in Maryland and Delaware, although facing heavy losses due to the sharp drop in prices in recent months, have gone on record against government price support and marketing agreements. They prefer to stand on their own feet as efficient producers, and to work back towards profitable operations once the overproduction from the inefficient operators, who would be protected by government support prices, is eliminated.

The politically attractive proposal — the "Brannan plan" — to allow market prices of non-basic commodities to be determined by free supply and demand, while the equivalent of the difference between market prices and the high support prices is given to farmers through direct payments from the Treasury, is a deceptive solution, and is so considered by leading farm organizations. Of course the payments could come only from the taxpayers. As Allan Kline, President of the American Farm Bureau Federation, has said:

> Experience has taught us farmers that paying for things by way of Washington is not the way to save money. A dollar seldom travels to Washington and comes back whole. Those of us who have had some experience in securing Congressional appropriations would hate to see farmers depending upon government checks for their net income.

The experience with potatoes will not have been entirely in vain if it teaches the country that as long as support prices are too high overproduction will be chronic. For too long our agricultural policy has been anchored blindly to price support without sufficient regard for what happens to production and consumption. The argument for these high price supports during the postwar period has been that they would "cushion" the transition from the inflated war and early postwar demands. The lesson of experience, however, seems to be that "cushioning" is chiefly another name for delay or prevention of necessary adjustments.

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